Moreover, unlike transactions between telco affiliates which often involve assets/services that are unique and highly customized and therefore not easily definable using market-based tests, cable affiliate transactions typically have readily available market prices for transactions with non-affiliates. Especially in the case of cable programming, virtually all affiliate transactions in the cable industry involve the purchase and sale of a product that is also offered to and purchased by non-affiliated cable operators and other video distributors. Thus, the Commission's traditional telco-based concerns with prevailing company pricing simply do not apply to cable.[34]

Finally, while there may be some limited types of affiliate transactions for which the "substantial number" test will not be met, TCI urges the Commission not to impose general rules anticipating these transactions at the outset, but rather to require operators to justify <u>challenged</u> rate increases. These showings should themselves not be limited to cost-based analyses; the reasonableness of affiliate charges could be shown through a variety of other means, such as comparable market transactions between non-affiliates, the degree of affiliation, etc.

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[34] Indeed, the congressional and Commission concerns with respect to affiliated programming transactions in the cable context have arisen for precisely the opposite reason that they have in the telco context: The concern in the cable area is that prices available from cable programmers to their cable operator affiliates may be preferentially <u>low</u>, rather than artificially high. <u>See</u>, <u>e.g.</u>, <u>Program Access First Report and Order</u>, 8 FCC Rcd. 3359, ¶¶ 95-96 (1993).

5. The Commission's Markup Provides Operators Little Incentive to Add New Regulated Programming and Creates a Regulatory Bias in Favor of High-Cost Services

a. Nature of the Problems

The Commission's proposal to establish the markup as a percentage of the costs of a program service borne by the cable operator has several fundamental shortcomings. The first is that the actual markups yielded by the 7.5% adjustment, even after the non-programming cost component from Table A is factored in, are disturbingly low and will not compensate cable operators for the many additional costs and risks incurred when they offer new program services.

In addition, the margin obtained by the operator must be sufficient to cover the risks of adding and continuing to carry unprofitable services. As several commenters have already noted, the 2 to 4 cent average per-channel markup produced by the Commission's formula does not come close to reimbursing operators for the costs and risks undertaken in adding new services, let alone generating a normal profit. As a result, operators will have little incentive to add new regulated programming services, contrary to Commission objectives.

The second shortcoming of the Commission's approach is that the operator's "programming costs," and hence the amount of the markup, are an artifact of the way in which the revenues for a particular service are generated and collected. The extent to which a service initially generates revenues to the cable operator, or to the service itself,[35] will determine the programming cost the operator incurs. Indeed, there may even be instances in which the operator is paid to carry the service.

Under the Commission's proposal there will be the greatest incentive to carry services for which the payments by the operator are the greatest, and the smallest incentive to carry services that the operator is paid to carry, because the permitted markup is a percentage of the amount the operator pays to the service. Thus, a major problem with the Commission's approach is that the central facet of its markup calculation, i.e., the cable operator's programming costs, depends entirely on the way in which revenues are initially received by both the cable system and the program service.

An additional problem with establishing the markup as a percentage of operator costs arises even if the sources of revenues are similar for two services. If the operator incurs additional costs when it adds a program service (e.g., marketing costs) that are independent of its programming costs, a bias is created in favor of programming services for which the operator is charged a high price to the detriment of "low-cost" or "no-cost" services. This is because the percentage markup on a high cost service may generate revenues that are sufficient to cover

[35] This, in turn, will depend on the ratings of the service, on the revenues generated by the service to the operator, and on the nature of the service itself.

the incremental costs, while the percentage markup on the low cost service may not.[36]

b. Proposed Solutions

1) Adopt TCI's $.25 "Competitive Markup" Proposal

TCI attaches to these Comments an economic analysis by Drs. Stanley M. Besen and John R. Woodbury that addresses the question of the maximum markup on programming costs that the Commission should permit cable operators to apply when they add regulated program services.[37]

In light of the inherent difficulties in determining the incremental costs and quantifying the risks that an operator incurs when it adds a new service, Besen and Woodbury instead estimate the "competitive markup," the markup that would be used by non-competitive systems if they faced effective competition and were not subject to regulation. The competitive markup is derived by taking the historical cable industry markup when a program service was added and adjusting that figure downward by the Commission's estimate of the competitive differential. The resulting competitive markup is the amount by which regulated rates would be permitted to increase over and above any additional programming costs when either a new channel or a new satellite service is added to a regulated tier.[38] Because the

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36 Besen and Woodbury at 17-18.

37 Besen and Woodbury, supra.

38 Besen and Woodbury at 2-3.

competitive markup is based on actual operator behavior, it provides a market-based estimate of the costs and risks of adding program services.

The analysis calculates the competitive markup for increases in total channels and increases in satellite services offered under two alternative assumptions about how programming costs are affected by the competition faced by a cable system. Using two different sources of data -- the GAO surveys of cable rates and the Commission's sample of rates charged by cable systems -- Besen and Woodbury demonstrate that the estimates of the competitive markup substantially exceed the markups that would be produced by the use of the Commission's proposed markup scheme. Specifically, the estimated average monthly competitive markup ranges between $.21 and $.34 (in 1994 dollars) per subscriber for an additional satellite channel. This compares with figures of approximately $.02 to $.03 for the average service using the Commission's approach. Based on this expert economic analysis, TCI proposes that the Commission adopt $.25 as the flat fee markup for adding new program services.[39] Of course, since this amount is in 1994 dollars, it would be adjusted upward over time to reflect the existence of inflation.

Importantly, TCI's competitive markup includes <u>all</u> costs associated with adding a new channel net of estimated operator

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[39] As Besen and Woodbury note, since they used the largest possible program charges in their calculations, the competitive differential will actually be understated for systems (such as large MSOs) that typically receive discounts from top-of-the-ratecard fees (<u>e.g.</u>, for volume). <u>See</u> Besen and Woodbury at 9.

programming costs. As such, the competitive markup represents a much simpler approach in that it replaces both the Commission's proposed 7.5% percent markup on operator programming costs and the non-programming cost increment contained in "Table A" in Form 1210.

Beyond the inherent simplicity of TCI's competitive markup approach, it affords other significant advantages. First, since it is based on the competitive differential, the competitive markup is consistent with the Commission's revised benchmark approach to setting initial regulated rates and can be used for deletions of channels and moving channels between regulated tiers.[40] It also ensures that channel additions or deletions on one tier do not affect rates on other tiers.

Second, TCI's approach corrects the bias in favor of high-cost services that is inherent in the Commission's proposal. Unlike the Commission's scheme wherein the markup is calculated as a percentage of operator programming cost, TCI's approach properly decouples the markup and operator programming cost components. By establishing the markup on a per-service basis, rather than as a percentage of operator programming costs, TCI's

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[40] Of course, to maintain symmetry and avoid the creation of skewed incentives, a corresponding "markdown" of $.25 should be applied when channels are deleted from regulated tiers. Thus, under TCI's approach, when a new regulated service is added, the operator could increase its rates by the operator's explicit payment to the programmer plus $.25. Correspondingly, when an existing regulated service is deleted, the operator must reduce its tier rate by the operator's explicit payment to the programmer plus $.25.

approach does not discriminate against low-cost or no-cost programming services.

Third, as Besen and Woodbury note, because the competitive markup simulates the markup behavior of competitive systems, the Commission need not be concerned about potential "offsets" to rate increases that may result, for example, when additional advertising revenues or promotional advances, are generated by a new service. Effectively competitive systems also obtain additional revenues from advertising, promotional advances, etc., when they add a service, and the markup charged by such systems will depend on the magnitude of these offsets. Since competitive systems also obtain these additional revenues, their existence is already accounted for in TCI's competitive markup.[41]

Fourth, because the competitive markup is sufficient to cover both an operator's explicit costs and the various risks an operator undertakes when adding new programming services, it will provide operators with unbiased market incentives to add new services to regulated tiers, thereby promoting the Commission's overriding objective in this proceeding. It is important to emphasize, however, that while TCI's proposed $.25 competitive markup will adequately cover explicit operator costs, it will not offset the hidden costs imposed on operators by the regulatory problems described in sections 1-4 *supra*.[42] If the Commission

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[41] Besen and Woodbury at 7.

[42] Recall that the markup should be adjusted over time to reflect increases in the general price level.

does not rectify these problems as outlined in TCI's proposed solutions, a higher markup than might otherwise be warranted will be required to counterbalance the vagaries and disincentives created by such regulatory treatment.[43]

Some may argue that TCI's proposal could induce some cable operators to add low-cost, low-quality services to their regulated tiers. As a business matter, TCI believes such a strategy would be counter-productive. Cable operators consider many factors when deciding whether to add services to a tier and which particular services to add. The increase in revenue per subscriber is only one such factor. Another important factor is "lift," i.e., the extent to which the added service will attract new customers to the system. Obviously, adding low-cost, low-quality programming will provide no lift. Operators also consider the likelihood that an added service will help retain existing customers. Again, low-cost, low-quality services will contribute nothing here and, in fact, could have the opposite effect.

Cable operators also must assess the opportunity costs of adding a low-cost service in the form of lost profits from alternatives they might carry. High-quality regulated services, a la carte services, and pay-per-view services are all claimants

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[43] For example, as one commenter has aptly observed in this regard, even a one-month delay of an operator's recovery of external costs will mean the operator will lose 1/12 (8.3%) of the year's revenues from that pass through, thereby nullifying the Commission's proposed 7.5% markup. Programming Providers at 18.

for channel capacity. Any of these services is likely to be more profitable than a low-cost, low-quality service and cable operators will be reluctant to forgo such opportunities.

The Commission could further reduce incentives to add low-cost, low-quality services by providing markups only on additional satellite channels. TCI has provided the Commission with data and analysis on both approaches. TCI notes that focusing on satellite channels -- because such channels typically involve more significant costs (e.g., satellite uplink costs) -- rather than on non-satellite channels, should reduce the likelihood that operators would be able to "game" the rules.

Finally, TCI believes cable operators are unlikely to adopt a low-cost, low-quality strategy in light of the mounting competitive threat from alternative video distributors. DBS recently initiated service. Local telcos have filed nearly 30 video dialtone applications. Moreover, Congress is considering legislation to repeal the cable-telco cross-ownership ban,[44] and two telcos have successfully challenged the constitutionality of the restriction.[45] In addition, SMATV, MMDS, and HSD continue to garner increased subscribership. In short, expanding

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[44] See H.R. 3636, 103rd Cong., 1st Sess., 139 Cong Rec. E-3114 (1993) and S. 1822, 103rd Cong., 2nd Sess., 140 Cong. Rec. 771-788 (1994).

[45] See Chesapeake and Potomac Tel. Co. v. U.S., 830 F. Supp. 909 (E.D. Va. 1993), Amended Final Order, Civ. No. 92-1751-1 (Oct. 7, 1993), appeal docketed, Nos. 93-2340 and 93-2341 (4th Cir. Oct. 15, 1993) (holding section 533(b) of the Communications Act unconstitutional as applied to Bell Atlantic within its service areas); U.S. West, Inc. v. United States, No. C93-1523R (W.D. Wash. June 15, 1994).

competition renders a low-cost, low-quality programming strategy highly unlikely.

2) Markup For Increases In Existing Service Rates

A separate markup will be required for increases in operators' costs for existing regulated programming services. TCI recognizes that the costs associated with the addition of a new channel are different from those that are incurred when an existing channel raises its rates.[46] The former may include costs for marketing, advertiser solicitations, expanding earth station capacity, encryption equipment, channel reassignments, and subscriber notification. Cable operators experience opportunity costs when they devote a channel to a particular new service. Some of these costs may not be present when an operator experiences a rate increase from an incumbent program service.

Nonetheless, it is appropriate, as the Commission has recognized, that an operator be compensated for the additional costs it incurs when a program service raises its rates. The Commission, has ruled that operators should be able to pass along program cost increases plus a 7.5% markup. Although TCI has demonstrated that such a markup scheme is not sufficient in the context of adding a channel, TCI believes it may be appropriate where an existing service raises its rates.[47] TCI, therefore, supports retention of the 7.5% markup for increases in costs for services already carried on the system.

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46 Besen and Woodbury at 14-15.

47 Id. at 15.

II. GOING-FORWARD PROPOSALS FOR CABLE SYSTEMS WITH SUBSTANTIAL CHANNEL CAPACITY

A. The Commission's Rate Regulation Scheme Should Not Apply Beyond 75 Regulated Channels

The Commission solicits comments on whether a separate methodology for adjusting capped rates is required for cable systems with more than 100 regulated channels.[48] Such a line of inquiry is compelled under the Commission's current going-forward methodology because "Table A" in Form 1210 only establishes per channel adjustments for systems with less than 100 regulated channels.[49] However, since TCI's competitive markup eliminates the need for a Table A component, focusing on a 100-channel threshold is not required. Indeed, TCI respectfully suggests that the Commission should instead set the demarcation point at 75 regulated channels and mirror the approach taken by the Commission in the context of setting channel-occupancy limits.

In its ownership proceeding, the Commission held that its channel occupancy limits apply only up to 75 channels and that "[a]ny additional channel capacity made possible through the use of advanced cable technologies will not be subject to the channel occupancy limits at this time."[50] The Commission based this determination on the fact that the expanded channel capacity that

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48 See Fifth NPRM at ¶ 257.

49 See FCC Form 1210, May 1994, Table A.

50 Ownership Second Report and Order, 8 FCC Rcd. 8565, ¶ 84 (1993).

will result from fiber optic cable and digital compression technology

> will help obviate the need for such limits as a means of encouraging cable operators to carry unaffiliated or competing video programming services.[51]

The Commission chose the 75-channel threshold because "[c]onventional cable distribution, in the absence of dual cable distribution plant, signal compression, or 'fiber-to-the-block,' enables the distribution of approximately 75 video channels."[52]

TCI believes that a similar 75-channel capacity threshold should also be adopted as part of the Commission's going-forward methodology. Specifically, the rules should provide that the Commission's rate regulation scheme should only apply to 75 regulated channels. Further, as determined in the ownership order, the rules need not necessarily apply to the _first_ 75 channels but rather to _any_ of the system's 75 regulated channels.[53] The operator would designate in its rate justification filings (_e.g._, perhaps as an extension to FCC Form 1215) which of its tiered offerings count toward the 75-regulated-channel threshold and perform the price-cap/going-forward calculations for these 75 channels. For example, if the operator carries 120 channels in its system that are marketed to subscribers as one tier of 50 channels, two tiers of 25 channels, and 20 _a la carte_ channels, the operator would designate the 50-

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[51] _Id._ at ¶ 83.

[52] _Id._ at ¶ 84.

[53] _See id._ at n.107.

channel tier and one of the 25-channel tiers as its regulated offerings. Rate increases/decreases and channel additions/deletions on these tiers would be governed by the Commission's price cap/going-forward rules. The remaining tiered and a la carte services would be unregulated.

This bifurcated regulatory scheme creates several positive incentives. Specifically, it will:

- encourage operators to increase their investment in enhanced cable infrastructures and expanded channel capacity;
- foster the widespread deployment of advanced technologies such as fiber optics and digital compression; and
- promote the carriage and diversity of new programming services on regulated tiers, thereby enhancing the viability of these program services.

Nor will TCI's approach harm subscribers since they will be assured of 75 channels of cable service at a regulated rate which will be capped on a going-forward basis. In this sense, subscribers are afforded even greater protection here than in the channel occupancy context, since TCI's proposal establishes 75 regulated channels as the threshold beyond which the going-forward limits would no longer apply, whereas in the channel occupancy context the Commission counts all system channels -- both regulated and unregulated -- toward its 75-channel threshold. Moreover, according to the statistics cited in the Ownership Second Report and Order, only 28% of cable subscribers receive 54 or more channels.[54] Thus, because in general it will

[54] Ownership Second Report and Order at ¶ 80.

take some time and much investment for operators to reach the 75-regulated-channel threshold, the Commission should not be concerned that this approach would trigger widespread deregulation of cable rates.

Finally, for the reasons discussed at 27-29 supra, operators will have little incentive to add low-cost, low-quality channels to their regulated tiers or to migrate a substantial number of quality services from regulated to unregulated offerings. To the extent such activity does occur, however, the preferable solution is to establish clear guidelines on what constitutes evasive behavior in this context and thereafter penalize only those operators who engage in such activities.

III. COMMERCIAL RATES

A. The Rate Regulation Provisions of the 1992 Cable Act Do Not Apply to Commercial Rates

1. The Language of the Statute and the Commission's Rules Indicate that Section 3 Covers Only Residential Subscribers

Section 3 of the 1992 Cable Act requires the Commission to establish a scheme for regulating rates for "subscribers."[55] The Commission's rules define "subscribers" as "member[s] of the general public who receives broadcast programming distributed by a cable television system and does not further distribute it."[56]

In a sense, a commercial establishment "further distributes" cable programming, i.e., it makes such programming available to

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[55] 1992 Cable Act Section 3(b)(2); 47 U.S.C. § 543(b)(2).

[56] 47 C.F.R. § 76.5(ee) (emphasis added).

persons who otherwise would not be receiving the programming. Arguably, therefore, a commercial establishment is not a "subscriber" at all under the Commission's rules. In the vast majority of cases, the residential subscriber who pays for the programming views the programming. This is different in scope and magnitude from the situation where thousands of paying patrons per week might view the programming in a bar or restaurant.[57] The music licensing entities, ASCAP and BMI, recognize this distinction and often seek additional payments from commercial establishments that offer cable service on the theory that such offerings constitutes a separate public performance. In short, a commercial establishment is the economic equivalent of an entity that further distributes the programming.

Moreover, the language of Section 3 speaks in terms of residential subscribers. For example, each of the three statutory tests for "effective competition" uses "households" as the measure of competition.[58] The Commission's Orders implementing Section 3 repeatedly equate "households" with "residences."[59]

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[57] Although a small number of people other than the paying subscriber may view programming in a residential subscriber's home, this does not alter the fact that the situation of a commercial establishment is fundamentally different from that of a residential subscriber.

[58] 1992 Cable Act Section 3(l)(1); 47 U.S.C. § 543(l)(1).

[59] See e.g., Third Rate Reconsideration Order at ¶¶ 15-17; Rate Order at ¶ 34.

Neither the Act, nor the Commission's definitions give any indication that rates to commercial establishments are to be regulated. Moreover, as shown below, the legislative history of Section 3 makes clear that Congress was concerned with residential cable rates and, in fact, did not consider commercial cable rates at all.

2. The Legislative History Demonstrates That Congress Was Concerned About Residential Rates and Did Not Consider Commercial Cable Rates

The legislative history on rate regulation focuses exclusively on residential rates. Congress repeatedly clarifies that it was concerned with residential rates by use of terms such as "households,"[60] "senior citizens,"[61] "ordinary people,"[62] and "average American family."[63] The Senate Report, for example, expressed concern that "only a small percent of the cabled homes" were protected by rate regulation under the Commission's 1991 definition of effective competition.[64]

By contrast, in the volumes of legislative history that were produced as part of the 1992 Cable Act, Congress never mentioned the issue of commercial rates. The Committee Reports do not

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[60] 138 Cong. Rec. S16675 (October 5, 1992) (statement of Sen. Adams) (emphasis added).

[61] Id.

[62] 138 Cong. Rec. H8671 (September 17, 1992) (statement of Rep. Markey) (emphasis added).

[63] 138 Cong. Rec. H11482 (October 5, 1992) (statement of Rep. Collins) (emphasis added).

[64] S. Rep. No. 92, 102d Cong., 1st Sess. 8.

mention commercial rates. The Conference Report does not mention commercial rates. TCI was unable to find any reference to commercial rates in the numerous hearings held by the relevant Committees. Given the considerable time the Committees and Congress spent on rate regulation and the voluminous legislative history that resulted from that effort, it is inconceivable that Congress could have had a concern with commercial rates and not raised that concern at any point during its consideration of the Act.

There is no indication that Congress intended to regulate commercial cable rates and, in fact, there is significant indication that Congress' sole concern was with residential cable rates. Therefore, the Commission should not extend its regulatory scheme to commercial rates.

3. It is Logical That Congress Did Not Regulate Commercial Rates Because Higher Commercial Rates Are Common in Competitive Industries

It is not surprising that Congress expressed no concern with commercial rates since it is common in competitive markets that rates charged to commercial subscribers are different from those charged to residential subscribers. TCI asked Charles River Associates ("CRA") to conduct the attached survey of cable systems that the Commission has identified as "effectively competitive" to determine their practices with respect to commercial rates. A majority of the systems contacted by CRA indicated that they <u>do</u> charge different rates to residential and commercial customers. For example, one system contacted by CRA reported that any facility "that's not residential" is charged the commercial rate of $49.95 per month for basic service versus the $23.75 residential rate.

Moreover, rates often vary among commercial entities, depending on the number of rooms in the commercial establishment, hotel, hospital, etc., as well as the occupancy rate. A number of systems CRA contacted indicated that hotels and motels have negotiated rates, depending on the number of rooms and services provided. One system reported that residential rates are $9 for "broadcast basic" and an additional $14 per month for expanded basic. The rate for commercial establishments like bars -- where service is considered publicly viewed -- is $49.95 for the package that includes expanded basic.

Price differentials between commercial and non-commercial entities are common in competitive markets. For example, in the information service industry price differentials are often based on the number of users of the information and therefore on the aggregate value of the service to the subscriber.[65] An example of such "value-of-service" pricing is the higher prices for business travelers on airlines (enforced by requiring advance purchase and Saturday night stayover for lower fares.)[66] Similarly, in its new pay-per-view offering, the NFL will

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[65] See, e.g., "Fee Plan to Share On-Line Data," New York Times, April 6, 1994, at D1.

[66] S. Borenstein, "Price Discrimination in Free-Entry Markets," 16 Rand Journal of Economics 380 (1985) analyzes this phenomenon.

maintain differentials between commercial and residential customers and sometimes will vary its commercial prices according to the size of the establishment.[67]

Price differentials based on differing elasticities of demand are not only common in competitive markets, but may be conducive to the maximization of total economic welfare. For example, absent price discrimination, some program services might not be financially viable. Finally, even if the total rate to a commercial establishment exceeds the residential rate, as noted above, a commercial establishment "redistributes" the cable service to many customers. Therefore, its rate per customer is likely to be far lower than that experienced by residential subscribers.

4. The Studies Congress Utilized To Support Its Conclusion To Regulate Cable Rates Did Not Include Commercial Rates

During consideration of the Act, Congress ordered the General Accounting Office (GAO) to conduct three studies on cable rates. These studies focused exclusively on residential rates.[68]

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[67] See "Around the NFL," Washington Post, April 13, 1994, at B5.

[68] The GAO studies requested rate information only on the "most common rate structure." See General Accounting Office, 1989 Survey of Cable Television Rates and Services, August 1989, pages 67, 70. See also, General Accounting Office, 1990 Follow-up Survey of Cable Television Rates and Services, June 1990, pages 68-69.

These studies are referenced repeatedly in the legislative history,[69] and clearly were a critical foundation of rate regulation provisions of the Act. In fact, the studies are cited in the statute itself as the very first official finding Congress made in the passage of the Act.[70]

The fact that the GAO rate studies were limited to residential rates demonstrates that Congress was not concerned with commercial rates and did not intend commercial rates to be covered by the Act.

The limited nature of the GAO studies underscores an additional point: <u>Congress had no information on commercial rates at the time the 1992 Act was debated and passed</u>. Thus, there is no evidence to suggest that Congress believed cable operators were charging unjustifiably high prices to commercial establishments. In the absence of any such evidence, the Commission should not impose its extensive regulatory scheme on commercial rates.

5. The Commission's Rate Analyses Did Not Include Commercial Rates

The Commission's own actions in implementing the rate regulation provisions of the Act have not included an analysis of commercial rates. In fact, the two main cable rate surveys the Commission conducted specifically excluded commercial rate information.

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69 <u>See</u>, <u>e.g.</u>, H. Rep. No. 628, 102d Cong., 2nd Sess. 31; S. Rep. No. 92, 102d Cong., 1st Sess. 5-8.

70 1992 Cable Act § 2(a)(1).

The Commission's Cable Rate Data Survey released on December 23, 1992,[71] did not collect commercial rate information. This survey was the principal basis for the first set of competitive benchmarks the Commission adopted in its original Report and Order.[72] Similarly, the Commission's Rate Survey of the Twenty Five Largest MSO's did not collect commercial rate information. In that study, the Commission specifically asked for "[T]he charges . . . generally available to residential households."[73] This survey was the basis for the Commission's conclusions concerning the extent of rate decreases since the onset of rate regulation.

The Commission's explicit exclusion from these two rate studies of any information on commercial cable rates reinforces the conclusion that commercial rates are not covered by the 1992 Cable Act. If Congress had intended commercial rates to be governed by the Act's rate regulation scheme, it clearly would have been appropriate to include commercial rates in the two Commission surveys.

Moreover, the Commission's exclusion of commercial rates from its surveys highlights the fact that the Commission has no basis to regulate commercial rates because it has no information on which to do so. The Commission does not know the level of

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[71] See 8 FCC Rcd. 226 (1992).

[72] 8 FCC Rcd. 5631 (rel. May 3, 1993).

[73] See FCC 93-244, Appendix, p. 2 (rel. September 17, 1993) (emphasis added).

rates charged to commercial establishments, either on an industry-wide basis or with respect to individual cable systems. It has no basis on which to compare the rates charged to different commercial establishments. It does not know how commercial rates compare to residential rates. Nor does it know the extent to which commercial rates differ between effectively competitive and other systems. Without this information, it would be arbitrary for the Commission to impose a regulatory scheme on commercial rates.

CONCLUSION

For the reasons set forth above, TCI respectfully urges the Commission to revise its going-forward methodology and to adopt rules regarding commercial rates consistent with the comments herein.

Respectfully submitted,

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A COMPETITIVE MARKUP APPROACH TO ESTABLISHING RATES WHEN ADDING CABLE PROGRAM SERVICES

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and

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June 29, 1994

1. INTRODUCTION

This paper addresses the question of the maximum markup on programming costs that the Federal Communications Commission should permit cable systems to apply when they add program services to their regulated tiers. The determination of this markup is of considerable importance to cable subscribers because, unless cable operators have adequate financial incentives, they will not offer the innovative services that many cable subscribers desire and are willing to pay for.

Cable operators incur many additional costs and risks when they offer new services. The explicit costs include those for marketing, advertiser solicitations, expanded earth station capacity, additional advertising insertion equipment, and the addition of amplifiers and other equipment to maintain signal quality. The operator may also incur costs for changing channel assignments, informing consumers of these changes, and acquiring additional encryption equipment.

In addition to these costs, carrying new services involves risks to the operator that may not be fully accounted for in the rates paid for these services. Since not every service will be successful, the operator will incur costs for some services, including the payments made to the service, that are greater than the additional revenues that the service generates for the operator. The markup obtained by the operator on successful services must be sufficient to offset the losses on those that turn out to be unprofitable.